GOVERNANCE

October 2014 Issue 244

The Italian way

‘Quotas make numerical change happen. The law needs the market and the market needs a “nudge” from the law. The final aim is the quality of boards, the contribution boards add to the management of a company and their ability to create sustainable value for the stakeholders. Only a sincere and mature engagement of the market can ensure that the numerical change develops into value for stakeholders.’

Livia Amidani Aliberti, founder, Aliberti Governance Advisors

The future of governance in the Gulf?

‘The scale of economic development is now so complex, significant and fast – even furious – that the region needs to embrace governance good practice with a heightened sense of urgency and commitment. No-one in the Gulf wants to see repeated the corporate collapses and value destruction which became the hallmark of the western economies during the financial crisis.’

Seamus Gillen, director of ValueAlpha

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Feature

Assessment of risk

Two rulings from the Financial Reporting Council (FRC) usher in a step change in how UK listed companies approach risk management. **Anthony Fitzsimmons** argues that compliance requires leadership from chairmen and chief executives.

Behavioural and organisational risks have come into sharp focus as a result of the post mortem on the banking crisis and research such as 'Roads to Ruin'[1], the 2011 Cass Business School report for Airmic, which found that the root causes of most crises lie in human behaviour and in the way that organisations are led, structured and managed.

We recently outlined[2] how companies can comply with the FRC's recommendation on reporting of Principal Risks. This means that Principal Risks with origins in inter alia behavioural and organisational risks are to be given a clear description and explanation.

The new FRC Guidance[3] on Risk Management, Internal Control and Related Financial and Business Reporting (the 'Risk Guidance') develops the theme by recommending that assessment of risk is integrated with other matters considered by the board, with board responsibilities for risk including:

> 'financial, operational, reputational, behavioural, organisational, third party, or external risks, such as market or regulatory risk, over which the board may have little or no direct control'.

The Risk Guidance goes on to recommend that the board should consider:

> 'whether it, and any committee or management group to which it delegates activities, has the necessary skills, knowledge, experience, authority and support to enable it to assess the risks the company faces and exercise its responsibilities effectively. Boards should consider specifically assessing this as part of their regular evaluations of their effectiveness'.

Unfortunately behavioural and organisational risks are beyond classical risk management know-how and thus not included in classical risk management schemes. Nor are the real root causes of reputational damage widely understood.

This presents a series of practical problems for boards. They have to extend risk management systems to include behavioural and organisational risks wherever it is found in the firm and integrate these and other risk factors into board discussions. Yet board members, and their risk teams, lack familiarity with this field.

In addition, in our experience even board members, let alone risk professionals, can be reluctant to explore behavioural and organisational risks for fear of what they may find or whom they may upset. This is understandable but very short-sighted. Identified whilst latent, these risks can be tamed before they wreck companies and their leaders' careers.

So how should boards extend risk management systems to include management of behavioural and organisational risks and their reputational consequences?

The starting point has to be an adequate understanding of these risks. We expect that almost all boards will find a skills gap as regards behavioural and organisational risks. Board members cannot be criticised – yet – for an inadequate understanding of these risks. But the FRC's encouragement to boards to evaluate their skills as to risk as part of the annual board evaluation process means that ignorance will soon become negligence. This is easily remedied by specialist education, giving boards the know-how to integrate these risks into their discussions and decision-making.

Delivery requires more. Boards need risk teams with skills that include behavioural and organisational risks and their reputational consequences, a rarity even among risk professionals. Again education is essential.

Having a competent risk team is not sufficient. Reflecting a key finding of 'Roads to Ruin', the Risk Guidance recommends boards to ensure that they and their risk teams have the:

> 'authority and support to enable [them] to assess the risks the company faces and exercise [their] responsibilities effectively'.

Only chairmen and chief executives can ensure that board members and risk teams can explore and report on these risk areas without fear that they are putting their careers at risk. Leaders will have to lead on this cultural change.

The solution can be made complicated but it need not be. A carefully constructed programme will efficiently deliver skills where they are needed, a re-tuned risk management system and a first analysis of behavioural and organisational risks and their reputational consequences with minimal disruption. From there the organisation can be self-sufficient, requiring only occasional external support.

The risk management profession has successfully dealt with whole families of risk, to the benefit of all. Behavioural and organisational risks are a new frontier but this destructive risk family can be tamed. The transformation of aviation safety over recent decades and our own research and experience show that – and how – this can be achieved.

[1] http://tinyurl.com/c52lll5
[2] *Governance* Issue 241 July 2014
[3] http://tinyurl.com/nsjhq8y

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